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Dear Member:

The Admin. is finally buckling down to a new economic policy. The President has hammered out details in meetings with top aides, including Vice Pres. Ford, will make his plans public this week.

Cutting back on the budget heads the new prescription list. Just about everybody involved is agreed that some cuts are needed. Differences center on amounts: Fed Chmn. Burns wants \$10 bill. off, Treasury Sec. Simon will take \$8 bill., budget chief Ash \$5 bill.

But even \$5 billion will be tough to lop off a tight budget. Officials talk of slashing the federal payroll, anti-crime money, percentage reductions in aid to education, housing, public works. Contracts can be strung out, federal funds for highways delayed. Even sacrosanct defense spending faces a \$1 bill. or more cut.

Nixon may ask Congress to cut previously mandated programs: e.g. food stamps, health, welfare payments, medicaid funds, etc. This has political overtones, bipartisan support would be tough.

The Admin. is also considering some changes in the tax area. It is unalterably opposed to a tax cut now and will carry the day, but has plans to ease the burden for low- and middle-income groups. Relief reforms include an "indexed" hike in personal exemptions, tied to the Price Index, a credit for high housing & food costs.

Nixon hopes to get some revisions in depreciation allowances, to reflect the horrendous increase in the cost of replacements, and productivity-inducing incentives to spur business investment. Variable capital gains rates are already in the Congressional mill.

The President may not spell out his program in this detail, when he talks to the nation on TV about the economy this week. But he will insist that the Admin. is now "on top of inflation, high interest rates," has contingency plans to stop any new surge. These will include some credit rationing and very tough jawboning.

The aim of this economic "activism" is to move the President out in front of Congress, show him as a leader fully in command. This is a posture he badly needs as the impeachment crunch nears.

Indeed, impeachment politics were one reason for the switch, Nixon's belated decision that a new economic policy was necessary. He badly needs a victory, didn't get one in the Mideast or Moscow. Kissinger got credit for the former; the latter proved a fizzle.

But pressure for a new policy built on many other fronts too. German Chancellor Schmidt warned the West faced financial ruin, urged Nixon to get moving on inflation, other economic issues.

The polls have been putting inflation at the top of U.S. concerns.

At the same time he has been trying to land a new economist: He wants Alan Greenspan to head up the Council of Econ. Advisers. But Greenspan balked, set a number of conditions on acceptance. In the process he forced a review of economic policy alternatives.

That led to the search for longer-term economic strategies, designed to put the U.S. on a sound-growth, no-inflation track. And Greenspan made another crucial point: the need for continuity.

That's why Ford met five times in one week with the Pres. Nixon had to nail down that once a new economic policy was set, Ford would stick to it if he should succeed to the Presidency.

What's happened to the profit squeeze? It's alive & hurting, despite the flood of reports showing record 2nd-quarter earnings. The fact is, profit growth isn't keeping up with volume growth, even including inventory gains, so margins are being pinched.

When all the figures are in, total 2nd-quarter net profits, "seasonally adjusted annual rate," will probably be higher again. But early figures indicate the increase over the record \$80 bill. net after-tax rate of the 1st quarter will be narrowed sharply.

And after an adjustment for the soaring "inventory profits" there'll most likely be a quarter-to-quarter drop in the total. This has been the pattern since mid-1973, will continue for now.

The still-climbing total profit numbers are creating problems for managements, especially in large publicly held corporations. Explanations about margins, inventories, etc. don't impress --

...Shareholders, who want to see their dividends increased. Trouble is, responsible dividend policies just can't be based on paying out the "paper profits" from inflated inventory values. And operating profits, in many cases, are far from satisfactory.

...Employees, already boiling mad over soaring inflation and the huge bite it is taking out of their take-home earnings. They're in no mood to forgo whopping "catch-up" pay increases, have no intention of waiting in line behind other company needs.

...Congress, which sees profits as a prime revenue source. Demands for higher corporate income taxes are already being heard. And it's hard to argue for greater tax incentives for investment when legislators can "clearly see" those astronomical earnings.

...Customers, who find it hard to accept "cost pressures" as justification for price increases in the face of huge profits. Business customers, at least, can be counted on to sympathize with growing profits plus narrower margins -- but not very much.

...The public, which is ready to blame big business anyhow

for today's high prices. A complicating public-relations factor: the temptation, which company managements aren't able to resist, to take full credit -- only partly deserved -- for the profit rise.

Will the profit climb continue? Any predictions are risky. Most economists and investment analysts, though, think it's over for this year, and will be followed by a drop in the second half.

Estimates of total 1974 profits now run 5%-10% above 1973. That's a sharp reversal from earlier projections of a 10% drop. But considering that 1st-half profits are already up by 15%-20%, that means these experts are expecting poorer 2nd-half results.

Better protection for ornamental designs of commercial items will be a byproduct of the Senate copyright bill, coming up soon. One section of the bill sets up a new "ornamental design patent," to resolve the conflict between copyright & patent protection.

The new patents would be good for an initial 5-yr period, plus a 5-yr renewal. The legislators figure that's long enough to cover the commercial life of most original ornamental designs. Filing would be simple, too, to encourage use of the procedure.

To qualify, a design would only have to be an "original" one. That's the same as what's now required to file for a copyright, and less than the stricter standards for getting a design patent.

An important element: Retailers who sell covered products would be specifically relieved of any liability for infringement. Presently, copyright & patent holders can use the threat of suits to intimidate dealers who carry competing "infringing" products.

RIA Observation: The Senate will probably approve the bill in this session, but time may well run out on it in the House. Eventual passage by the next Congress seems a good bet, though.

With the Mediterranean basin aflame from Cyprus to Portugal, the urgent question arises as to whether the U.S. can stay out. Despite frantic Kissinger efforts to placate Greeks and Turks by the issuance of soothing statements, consensus is that it can't.

What's happening along NATO's Southern tier is too serious, threatens not only military, but economic & political stability. Already, a major split threatens within NATO over Cyprus events that has left the U.S. isolated as defenders of Greek colonels.

Kissinger argues that it is better to deal with the gunmen who now run Cyprus -- new Pres. Samson was a terrorist killer -- than risk offending the Athens colonels who engineered the coup. Otherwise, Athens might toss the Sixth Fleet out of Greek ports.

Thrust of U.S. policy is to keep the new Cypriot government

from advocating "enosis" -- union of the big island with Greece. Turkey won't stand for that, will move in under treaty guarantees. The result, of course, would be open war between two NATO members.

The rest of NATO, led by Britain, wants to restore Makarios, use the opportunity of the current crisis to oust the military. Russia, always eager to foment trouble, has lined up with Turkey, a nation with which U.S. ties are frayed because of the dope trade.

Odds are that some kind of new Cyprus agreement will be made, but only with active U.S. participation, including the 6th Fleet. That, however, will leave festering wounds on NATO's body politic, won't improve U.S.-Greek-Turkish naval coordination in the area. Greek and Turkish ports are needed to balance Soviet naval might.

Move along the Southern tier and things aren't any better. Italy is still in danger of economic collapse, resultant chaos. No one rules out a Communist bid for power or a right-wing coup. Again, such upheaval would threaten the U.S. naval position there, dislocate the hinge of NATO strategy in the whole Mediterranean.

In Portugal, Pres. de Spínola's grip on gov't is all but gone. A left-leaning colonel is trying to shore up the shaky economy. Implications clearly favor continued political instability there. That likely means growing chaos in Portugal's African possessions.

There's talk that South Africa will move into the vacuum, occupy Mozambique if the Portuguese authority dissolves in chaos. U.S. officials shudder when they contemplate results of that one.

With Gen. Franco ill, perhaps nearing death or retirement, Spain is suffering from a case of galloping political jitters. Leaders of the ruling National Movement are preparing new steps, trying to bring in other moderate political groups before he dies. But it is probably too late to avoid post-Franco political chaos.

There are no easy U.S. answers to any of these problems. But clearly the U.S. cannot ignore the consequences of neglect. Meeting them will require subtle use of military, economic muscle.

Unhappily, that muscle has become increasingly atrophied -- an argument the Pentagon will use in demanding more defense money. Given the current pressure for cutting the defense budget hard, what is now happening in the Mediterranean will be a big factor.

Point is that "small" crises -- if there are enough of them -- require U.S. concern, just as "cosmic" issues like U.S.-USSR ties. That national policy debate Kissinger proposed after the summit is likely to be much broader & more complicated than he expected.

Research Institute Staff